United States Court of Appeals for the Second Circuit

Nos. 23–24, October Term, 1954

Argued April 21, 1955—Decided June 2, 1955

Docket Nos. 22989–90

J. J. Dix, Inc., petitioner

v.

Commissioner of Internal Revenue, respondent

Estate of Jacob J. Dix, deceased, petitioner

v.

Commissioner of Internal Revenue, respondent

Before: Frank, Medina and Hincks, *Circuit Judges.*

Appeal from decisions of the Tax Court of the United States, Judge Van Fossan. Affirmed as to *J. J. Dix, Inc.* v. *Commissioner;* reversed as to *Estate of Jacob J. Dix* v. *Commissioner.*

Frank, Circuit Judge:

The facts and rulings of the Tax Court are set forth in the opinion of Judge Van Fossan, reported unofficially in 12 T. C. M. 536.

I

The Corporate Taxpayer's Appeal

The Tax Court found that the corporate taxpayer, during the years 1938 through 1944, realized net taxable income amounting to $62,054.23 in excess of the amounts recorded on its books and reported on its tax returns filed for those years. It is undisputed that the corporation during the above period realized from its sales the sum of $196,870.60 which was secretly deposited in two banks, and that the amounts so received were not recorded on its books or included in gross receipts on its tax returns. The Commissioner, in determining the deficiencies, increased the corporation's annual sales income, by that amount, without allowing a deduction, because it was not recorded on the corporation's books as required by Sections 41 and 54 (a) of the Internal Revenue Code of 1939.

The Tax Court found, and taxpayer conceded, that the corporate gross income had been understated in the total sum of $196,870.60. It found further, however, that the corporation was entitled to deductions aggregating $134,816.37, and therefore that its taxable income had been fraudulently understated and unreported in the remaining sum of $62,054.23, redetermining the deficiencies and fraud penalties accordingly.

Taxpayer contends that the corporation is entitled, in addition to the deductions allowed by the Tax Court, to further deductions exceeding $62,000 as follows: (a) overceiling payments of approximately $25,000 purportedly made in behalf of the corporation by its president, Jacob Dix, to black-

market wastepaper dealers; (b) overceiling wages totalling about $28,800 allegedly paid in cash by Jacob to the corporation's production employees; (c) approximately $3,000 paid by Jacob as commissions over and above the total amount thereof ($20,000) allowed by the Tax Court; and (d) overceiling extra salaries of $5,317.41 allegedly paid to the corporation's office and factory employees by vice-president Monroe Dix. The Tax Court, for failure of proof, denied the deduction of these additional items, and the taxpayers assert that this is error. We submit that there is no merit in these contentions.

We think the Tax Court's decision correct. Judge Van Fossan's opinion, analyzing in detail the taxpayer's evidence, shows that taxpayer did not discharge its proof-burden. And its proof left the matter so vague and conjectural as to render it impossible, as the Tax Court held, to apply the doctrine of *Cohan* v. *Commissioner*, 39 F. (2d) 540 (C. A. 2).

Taxpayer contends, alternatively, that the sum of $56,736.82, out of the total unreported sales proceeds, represents corporate funds misappropriated by Jacob, and therefore the corporation is entitled to deduction of this sum as a loss sustained during the years 1938 through 1945, under Section 23 (f) of the 1939 Code. The Tax Court found, we think correctly, that the taxpayer did not show the amount of the misappropriation or the years in which misappropriations occurred. It said: "No basis exists in the evidence to make an estimation of the amount of money improperly taken by Jacob. For this reason, the deductions

for any losses sustained as a result of misappropriated funds must be denied the corporation." Moreover, there was no proof that the corporation will not recover from Jacob's estate whatever amounts he did misappropriate.

The evidence, and entirely reasonable inferences drawn from the evidence, demonstrate that the Commissioner discharged the burden of establishing fraud by clear and convincing evidence of wilful intent to evade taxation, and that therefore the imposition of 50% fraud penalties was justified. Because of the fraud, the statute of limitations was inoperative.

The adjustment of income for the several taxable years caused over-assessments of excess profits for other years. Taxpayer contends that it is entitled, as an equitable setoff against deficiencies, to refunds of such over-assessments, although such refunds are barred by the statute of limitations. We do not agree. See *Babcock & Wilcox Company* v. *Pedrick,* 212 F. (2d) 645, 648–649 (C. A. 2).

II

The Estate of Jacob J. Dix

The Tax Court held that Jacob Dix realized taxable income of $56,736.82, i. e., the amount of corporate funds he misappropriated. We think this was error. Jacob withdrew those moneys from the corporate bank accounts without the consent, coerced or otherwise, of the company. That he was the president did not amount to corporate consent. We have here a simple case of embezzlement, not one involving a receipt under any color of right. Accordingly, we think

Commissioner v. *Wilcox,* 327 U. S. 404, governs, and that *Rutkin* v. *United States,* 343 U. S. 130, does not apply. We do not believe that *Rutkin* completely obliterated *Wilcox.* "Since the court in *Commissioner of Internal Revenue* v. *Wilcox* flatly held that embezzled funds were not taxable income to the embezzler and in the Rutkin case has unequivocally held that funds were taxable income to the extortionist, the line of demarcation lies between those rather closely related factual situations and must be determined by the facts in the individual case." *Marienfeld* v. *United States,* 214 F. (2d) 632, 637 (C. A. 8) [certiorari denied, 348 U. S. 865]. In the instant case, the facts are close to those of Wilcox, and lack the distinguishing features found in *United States* v. *Bruswitz,* 219 F. (2d) 59 (C. A. 2) [certiorari denied, 349 U. S. 913], and cases there cited. See also the dissent of Judge Kalodner in *Kann* v. *Commissioner,* 210 F. (2d) 247, 253 (C. A. 3) [certiorari denied, 347 U. S. 967].

Affirmed as to J. J. Dix, Inc.; reversed as to Estate of Jacob J. Dix.

HINCKS, *Circuit Judge* (dissenting in part):

Although I concur in the holding of the court in so far as it affirms the decision below, I am unable to join in the partial reversal. I share the difficulty which this court had in *United States* v. *Bruswitz,* 219 F. 2d 59 [(C. A. 2), certiorari denied, 349 U. S. 913], in distinguishing the rationale of *Commissioner* v. *Wilcox,* 327 U. S. 404, from that of *Rutkin* v. *United States,* 343 U. S. 130. But having in mind the findings below—well supported by the record—that Jacob Dix, who dominated the corporate taxpayer, a family

corporation, by deceiving his son, who was the only other responsible corporate executive, fraudulently witheld the entry of corporate receipts from the corporate books and utilized his authorized power to draw on corporate bank accounts by diverting funds to his own personal use, I think the facts here are stronger against the taxpayer than in *Wilcox* and come within the rationale of the *Rutkin* case. Cf. *Kann* v. *Commissioner,* 210 F. 2d 247 [(C. A. 3), certiorari denied, 347 U. S. 967]; and *Marienfeld* v. *United States,* 214 F. 2d 632 [(C. A. 8), certiorari denied, 348 U. S. 865]. And if such facts are not enough to distinguish the case here from *Wilcox,* I think the court below was right in following the later pronouncement of the Supreme Court.

Judgment

United States Court of Appeals Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 2nd day of June one thousand nine hundred and fifty-five.

Present: Hon. JEROME N. FRANK, Hon. HAROLD R. MEDINA, Hon. CARROLL C. HINCKS, *Circuit Judges.*

ESTATE OF JACOB J. DIX, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed in accordance with the opinion of this Court.

[S] A. DANIEL FUSARO, *Clerk.*

A true copy,

[S] A. DANIEL FUSARO, *Clerk.*

FILED JUN 2, 1955.

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SEP 19 1955
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM 1955

No. 363

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

ESTATE OF JACOB J. DIX, Deceased.
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Memorandum for the Respondent.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1955

COMMISSIONER OF INTERNAL REVENUE, *Petitioner*, v. ESTATE OF JACOB J. DIX, Deceased.	No. 363

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Memorandum for the Respondent.

Opinions Below

Memorandum findings of fact and opinion of the Tax Court of the United States (R. 9-38) are not officially reported. The opinion of the Court of Appeals (Pet. 1a-6a) is officially reported in 223 Fed. 2nd 436.

Jurisdiction

The judgment of the Court of Appeals was entered on June 2, 1955. (Pet. 6a-7a) The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

Questions Presented

1. Whether the deceased taxpayer realized taxable income when he embezzled funds for his own use and benefit to the detriment of the stockholders and the family-owned corporation in which the taxpayer owned no stock?

In the event the Court grants certiorari on the above issue, the taxpayer will urge the following questions for review:

2. Whether the wording of the Statutory Notice of Deficiency sent by the petitioner to the taxpayer and the agreement of the parties to this proceeding, that any amount drawn by Monroe Dix and Jacob Dix from the two omitted bank accounts of the corporation and not returned to or spent on behalf of the corporation was withheld from and is due to the corporation, precludes taxing said amount as income to the deceased taxpayer?

3. Whether the determination of the Tax Court of the United States that Jacob J. Dix derived taxable income of $56,736.82 from misappropriated funds is correct in view of its own findings that a substantial part of that amount was spent for overceiling payments for wastepaper to obtain a supply of paperboard for the corporation, and possibly for overceiling wage payments, but for which no allowance was made on the ground that a computation of such amount was too difficult or speculative to determine?

4. Whether the inability of the deceased taxpayer to prove the payment of corporate expenses with corporate funds received by him results in taxable income to the deceased taxpayer? And if such be the case, whether the omission of such amounts from the income tax return of the deceased taxpayer, standing alone and by itself, is proof of fraud?

5. Are the assessments of deficiencies in taxes against the deceased taxpayer for the calendar years 1938 through 1941 barred by Section 275 of the Revenue Act of 1938 and the Internal Revenue Code of 1939?

6. Was the income tax liability of the deceased taxpayer for the calendar year 1942 discharged by Section 6 of the Current Tax Payment Act of 1943?

Statutes Involved

The statutes involved are those set forth in the petition. (Pet. 2-3)

The additional statutes involved on the questions that the taxpayer will urge for review are:

Revenue Act of 1938, c. 289, 52 Stat. 447:

Sec. 275. Period of Limitation upon Assessment and Collection.

Except as provided in section 276—

(a) General Rule. The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

Sec. 276. SAME. EXCEPTIONS

(a) False Return or No Return. In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) Waiver. Where before the expiration of the time prescribed in Section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

Sections 275(a) and 276 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Secs. 275 and 276) applicable to the taxable years 1939 to 1941, inclusive, are substantially the same as Sections 275(a) and 276 of the Revenue Act of 1938, *supra*, applicable to the taxable year 1938.

Current Tax Payment Act of 1943

Sec. 6. Relief From Double Payments in 1943

(a) Tax for 1942 not Greater Than Tax for 1943.

In case the tax imposed by Chapter 1 of the Internal Revenue Code upon any individual (other than an estate or trust and other than a non-resident alien not subject to the provisions of Sections 58, 59 and 60 of such chapter) for the taxable year 1942 (determined without regard to this section, without regard to interest or additions to the tax, and without regard to credits against the tax for amounts withheld at source) is not greater than the tax for the taxable year 1943 (similarly determined) the liability of such individual for the tax imposed by such chapter for the taxable year 1942 shall be discharged as of September 1, 1943, except that interest and additions to such tax shall be collected at the same time and in the same manner as, and as a part of, the tax under such chapter for the taxable year 1943. In such case if the tax for the taxable year 1942 (determined without regard to this section and without regard to interest or additions to the tax) is more than $50, the tax under such chapter for the taxable year 1943 shall be increased by an amount equal to 25 per centum of the tax for the taxable year 1942 (so determined) over $50, whichever is the lesser. This sub-section shall not apply in any case in which the taxpayer is convicted of any criminal offense with respect to the tax for

the taxable year 1942 or in which additions to the tax for such taxable year are applicable by reason of fraud.

Statement

The facts set forth in the statement of the case by the petitioner (Pet. 3-9) are essentially correct except that the corporation's deposits in the Sterling National Bank and the Public National Bank were not secret. These deposits were known to Monroe Dix as well as to others. What was unknown to Monroe Dix and the stockholders was that the transactions in these two banks were not reflected on the corporate books and the corporate tax returns.

The following additional facts are of moment to the determination of the issues.

The Statutory Notice of Deficiency, addressed to taxpayer by the petitioner, explains the other income being taxed to Jacob Dix as "this amount represents moneys received from funds withheld due to the corporation, J. J. Dix, Inc., during the year."

The parties to this proceeding have agreed that any money drawn by the taxpayer from the two omitted bank accounts of the corporation and not returned to or spent on behalf of the corporation was withheld from and is due to the corporation.

The relationship between Monroe Dix, Vice President and principal stockholder of J. J. Dix, Inc., and his father, Jacob Dix, deceased, was a continually strained one from 1935 on, often bordering on open litigation, and culminating in 1945 when Monroe Dix, after discovering that the records of the corporation did not reflect all of the sales, costs and expenses, compelled his father to agree to notify the Bureau of Internal Revenue of the facts in the case.

In the consolidated proceeding before the Tax Court, that Court found that Monroe Dix had not received any amount from the unreported sales proceeds as income.

J. J. Dix, has claimed from and discussed with the Executor of the Estate of Jacob J. Dix the return to the corporation of any amounts taken by Jacob Dix from corporate funds and not spent on behalf of the corporation. The Estate of Jacob Dix, in January 1952, had cash of $29,500 and marketable securities of the value of $17,000.

In 1945, the Port Morris Sales Company was organized, in which partnership the deceased taxpayer owned a 50% interest. From the time of organization until Jacob Dix died in 1948, that partnership earned very substantial amounts of money. The first fiscal year of the partnership ended in 1946.

J. J. Dix, Inc. did not declare any dividends from 1938 through 1945.

The Tax Court found as a fact that of the initially unreported sales of $196,870.60 of J. J. Dix, Inc. $140,133.78 was subsequently returned to the corporation during the years at issue and reported as sales income or spent on behalf of the corporation. Thus, the maximum amount that the deceased taxpayer could have received as income was $56,736.82. The Court then recognized that some portion of the unreported sales funds was also spent in over-ceiling payments to wastepaper dealers and possibly in over-ceiling wage payments, but did not further reduce the $56,736.82 for these items since the amounts could not be ascertained with regard to specific years.

Charles Carver, Special Agent, the only witness called by the Commissioner before the Tax Court, did not know whether or not the moneys claimed to have been spent by Jacob Dix for the account of J. J. Dix, Inc. were so spent.

The witness was not aware, and did not give any consideration to the fact that substantial amounts were paid into the corporation by the taxpayer and credited to sales income. Charles Carver instructed the Revenue Agent to set up the fraud penalties because it was the practice of his office to impose the fraud penalty wherever sales income is omitted. The fraud penalty was asserted against Jacob Dix for 1945 solely because he withdrew funds in 1945 from the Public National Bank account of the corporation.

The income tax returns of Jacob Dix for the calendar years 1938 through 1942 were filed on or before March 15, 1943. The appellant determined deficiencies against the taxpayer on November 9, 1949. The Estate of Jacob Dix pleaded that the deficiencies for the years 1938 through 1941 were barred by the Statute of Limitations and that the Current Tax Payment Act of 1943 discharged the 1942 tax liability.

Reasons for Denying the Writ

The issue in the present case is narrowly restricted to one of particular facts, and no amount of strained semantics can convert it into one of general principles warranting review by this Court on certiorari. The Court of Appeals, below, made this fact abundantly clear when after citing the principles involved in *Commissioner* v. *Wilcox*, 327 U. S. 404 and *Rutkin* v. *U. S.*, 343 U. S. 130, stated:

> "In the instant case the facts are close to those of Wilcox and lack the distinguishing features found in *U. S.* v. *Bruswitz*, 219 F. (2d) 59 (CA. 2) (Cert. Den. 349 US 913), and cases there cited."

The cases cited in *U. S.* v. *Bruswitz, supra*, are the very cases relied on by the petitioner in his request for certiorari.

What the petitioner alleges to be conflicting decisions was not so considered by the court below. That Court did not take issue with the decisions of other circuits in the particular cases referred to, but in its judicial wisdom found distinguishing features which made the principles and law expressed therein non-applicable to the case of the instant taxpayer.

The Supreme Court itself has apparently considered the line of demarcation between the *Commissioner* v. *Wilcox, supra,* and *Rutkin* v. *U. S., supra,* to be one of fact applicable to the particular case and has refused to disturb determinations of the Courts of Appeal in this field. *Briggs* v. *U. S.,* 214 F. 2d 699, Cert. Den. 75 S. Ct. 86; *Marienfeld* v. *U. S.,* 214 F. 2d 632, Cert. Den. 75 S. Ct. 87; *Kann* v. *Commissioner of Internal Revenue,* 210 F. 2d 247, Cert. Den. 74 S. Ct. 778; *U. S.* v. *Bruswitz,* 219 F. 2d 59, Cert. Den. 75 S. Ct. 600. In fact, this very principle of non-review of factual issues had been successfully urged in those cases by the petitioner in this case. There is therefore no reason why the Supreme Court should depart from its policy of refusing to review purely factual issues. To do so would lead to innumerable factual appeals and an increased burden upon the Supreme Court. This Court should not be led astray by spurious arguments that the decision in the case has created uncertainties in the lower Courts.

On the facts, the decision of the Court of Appeals in this proceeding was manifestly correct. Based on the findings of fact of the Tax Court, Jacob Dix, a non-stockholder, had misappropriated funds belonging to his corporate employer. This misappropriation was for his own personal use and benefit, to the detriment of the corporation and its stockholders and not approved or condoned by them.

These facts have been acknowledged in part by the petitioner and found to be entirely correct by the Court below. In fact, claim for the return of any misappropriated funds has been made by the corporation against the Estate of the deceased taxpayer.

There is no question that Jacob Dix did not receive these funds under a "claim of right" or that he was indebted to the corporation for the said amounts from the inception of the misappropriations. This has been admitted by the petitioner in his Statutory Notice of Deficiency addressed to the taxpayer and by stipulation before the Tax Court. On the basis of this latter fact alone the decision of the Court below can be sustained.

As in *Commissioner* v. *Wilcox, supra,* the deficiencies proposed against the Estate of Jacob Dix will more than offset the assets of the Estate and deprive the injured parties of any financial means of recovery. Moreover, the decision of the Court of Appeals in the case of this taxpayer undoubtedly had a bearing upon its decision in the companion case of *J. J. Dix, Inc.* v. *Commissioner of Internal Revenue,* wherein the Court denied a deduction to the corporation for embezzled funds in view of possible eventual recovery of its loss from the Estate. (This was obviously predicated upon the Court's reversal of the Tax Court in the case of the Estate of Jacob J. Dix.)

The decisions cited by the petitioner as being in conflict with that of the court below in the present proceeding are distinguishable on the facts. In none of the cases cited by petitioner did the Courts of Appeal hold as a matter of law that funds embezzled from an employer are taxable income to the embezzler. There is therefore no conflict on this issue among the circuits. The differences in facts from the *Kann* case are glaring.

In *Kann* v. *Commissioner, supra,* the taxpayers, two brothers, owned approximately 25% of the stock of the companies from which they allegedly embezzled funds and in addition were trustees of an additional 40% of the stock. The two brothers were the sole management of Pittsburgh Crushed Steel Co., the employer. In the instant case, Jacob Dix did not own, and except for qualifying shares, had never owned stock in J. J. Dix, Inc., and the management of the the company was divided between Monroe Dix, found to be a wholly innocent party, and the taxpayer. Jacob Dix only had a life interest in a trust which trust had a ⅓ interest, later reduced to a ¼ interest, in a voting trust of which a non-related person was trustee.

The Tax Court, as well as the Court of Appeals, in the *Kann* case stressed the fact that the imposition of the Federal tax deficiencies would not deprive the injured party from recouping what was due and both Courts believed this was an important factor in the Supreme Court decision in *Commissioner* v. *Wilcox, supra.* In the case of the instant taxpayer, the imposition of the proposed deficiencies will certainly deprive the corporation of any possibility of recouping misappropriated funds.

In the *Kann* case, the Court of Appeals stressed the Tax Court finding that there was "no adequate proof that the method, if not the act, has not been forgiven or condoned", and that the supposed liability to repay was "such as to leave serious doubt whether the whole project was not a false front erected to deceive not the corporation or its stockholders but the Commissioner of Internal Revenue." In the instant proceeding, there is no question that any misappropriation of funds has not been condoned and claim therefor has been made. The Court below held that the taxpayer's misappropriations were without the consent,

coerced or otherwise, of the company. That he was president did not amount to corporate consent.

In *U. S.* v. *Bruswitz, supra,* the taxpayer had been the recipient of commercial bribes and had not embezzled funds within the meaning of the New York penal law. It was this factor that lead the Court of Appeals to distinguish the facts from the *Wilcox* case, since there was no continuing obligation to restore the funds to an employer,—a liability which would have been subordinated to the Government lien had the tax been found appropriate.

In the *Bruswitz* case, the Court of Appeals said there was no indication that the kickbacks resulted in any loss to the defendant's employers.

In *Marienfeld* v. *U. S., supra,* the Court found that the taxpayer's fraud was not in fact embezzlement but the conversion of certain products of his employer to his own use and then the act of sale of those products for his own account. Thus the proceeds pocketed by Marienfeld had never been an asset of or in possession of the employer. In the case of the instant taxpayer, the Estate of Jacob Dix, the court below has found as a fact that Jacob Dix's misappropriations from the corporation were true embezzlement.

In *Briggs* v. *U. S., supra,* the Court of Appeals distinguished the facts from *Commissioner* v. *Wilcox, supra,* pointing out that Briggs was not an agent of the company, unquestionably received his share of the money in his own right and not as an agent or employee, and who could have been required to account for the money to the corporation only on the theory that he had participated in and abetted a fraud. Here again there was no embezzlement of moneys having been part of the assets of the employer. The facts are quite different from those in the instant proceeding.

CONCLUSION

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

BERNARD WEISS,
Attorney for Respondent.

September 14, 1955